



Why States Should Adopt the...

Revised Uniform Limited Liability Company Act (2006)

Limited liability companies (LLCs) are a relatively new form of unincorporated business organization providing corporate-style limited liability to its owners; LLCs began to be widely used after Revenue Ruling 88-76 upheld their taxation as partnerships. Every state has enacted some sort of LLC legislation and LLC filings approach and in many states outnumber the number of new corporate filings on an annual basis. The existing state LLC statutes, however, are far from uniform and many have been amended on a patchwork basis and have not kept up with the LLC cases and other legal developments.

The Uniform Law Commission (ULC) promulgated the original Uniform Limited Liability Company Act (ULLCA) in 1995 and amended it in 1996 to take into account the then newly adopted federal tax "check-the-box" regulations. It, like most existing state LLC statutes, can be classified as a "first generation" statute. The **2006 Revised Uniform Limited Liability Company Act (Re-ULLCA)** is a comprehensive, fully integrated "second generation" LLC statute that takes into account the best elements of the "first generation" LLC statutes and two decades of legal developments in the field. Here are some of the more significant changes and innovations in **Re-ULLCA**:

- **The operating agreement.** In Re-ULLCA, the operating agreement, rather than the certificate of organization, determines whether an LLC is member-managed or manager-managed. Re-ULLCA also makes it clear that the operating agreement is binding on the LLC even in the case of a single member LLC and even if the LLC has taken no formal action to adopt the operating agreement.
- **LLCs may engage in any lawful purpose.** Under Re-ULLCA, an LLC is not restricted to for-profit business activities. It can have "any lawful purpose, regardless of whether for profit." This expands the availability of LLCs to family vacation homes and organizations whose activities might be classified as non-profit.
- **Internal affairs default rules.** Re-ULLCA contains a basic set of internal affairs default rules governing the relationship members and managers of an LLC between themselves and each other, most of which can be varied by the operating agreement. For example, if the operating agreement is silent on the type of management structure, an LLC is member-managed by default. There are also default rules for decisions by members and managers and for other matters.
- **Flexible management structure.** Under Re-ULLCA, it is possible to have any type of management structure the LLC members want, including a corporate-style board of directors and officers. The type of management structure is set forth in the operating agreement.
- **Dates and liabilities of managers.** Re-ULLCA incorporates the fiduciary duties of loyalty and due care for managers and clarifies the contractual status of the duty of good faith and fair dealing. These duties may be restricted or eliminated "if not manifestly unreasonable." The business judgment rule is applicable to a case involving a breach of due care claim. The operating agreement may limit or eliminate liability of a manager to the LLC or other members for monetary damages except for breaches of the duty of loyalty, improper distributions, intentional infliction of harm to the LLC or a member or an intentional violation of criminal law. These rules are similar to those found in state corporation statutes.
- **Shelf LLC.** It is possible under Re-ULLCA to file a certificate of organization before an LLC actually has a member. A second filing made once a member is appointed completes the formation of the LLC, assuming the second filing is made within 90 days of the first filing.
- **Agency authority.** The authority of members and managers to bind an LLC is determined by agency law and not by status, as is the case under most existing LLC statutes. Certificates of authority may be filed in the office of the Secretary of State (and in the case of real estate in the office where real estate records are kept) to provide notice that only certain members or managers have authority to conduct business on behalf of the LLC.
- **Charging orders.** Re-ULLCA clarifies and simplifies the rules governing charging orders, the exclusive remedy for a creditor of a member to obtain a member's financial rights to distributions from the LLC. Re-ULLCA also provides the rules for foreclosing on a charging order and makes it absolutely clear that a purchaser of a foreclosed interest only obtains financial rights and does not

become a member of the LLC by virtue of the foreclosure.

- **Distributions.** Re-ULLCA specifies the circumstances under which distributions from an LLC can and cannot be made and contains provisions for recovery of improper distributions. Re-ULLCA also makes it clear that payment for reasonable compensation and for retirement plans or other benefits programs are not distributions.
- **A remedy for oppressive conduct.** Reflecting case law developments around the country, Re-ULLCA permits a member to seek a court order "dissolving the company on the grounds that the managers or those members in control of the company have acted or are acting in a manner that is oppressive and was, is, or will be directly harmful to the member.
- **Direct and derivative claims, special litigation committees.** Under Re-ULLCA, a member can bring a direct action for injuries to that member and can bring a derivative action to enforce a claim of an LLC. If a derivative action is filed, the LLC may form a special litigation committee to investigate the asserted claims. This stays the litigation while the committee does its investigation. The objective of the investigation is to determine if the litigation is for the good of the company.
- **Reorganization transactions.** Re-ULLCA has comprehensive provisions authorizing LLCs to merge or convert into another type of entity and also authorizes other types of entities to merge and convert into an LLC. Re-ULLCA authorizes an LLC to domesticate in another state and also authorizes a foreign LLC to domesticate in the enacting state.

Re-ULLCA represents a significant advancement in this area of law. Some of the benefits of uniformity include reduced compliance costs, streamlined administration (which reduces costs to states) and decisive consistency across jurisdictions.

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